Revenue Ruling 89-89 1989-2 CB 231 July 3, 1989. I.R.B. 1989-27, 11

ISSUE

If a decedent elected a distribution option from an individual retirement account (IRA) that requires the date of death balance to be distributed in annual installments to a testamentary qualified terminable interest property (QTIP) trust and the income earned on the undistributed balance to be paid annually to the trust, and if the trust requires that both that income and the income earned by the trust on the distributed portion of the IRA be paid currently to the decedent's spouse for life, can the decedent's executor elect under section 2056(b)(7) of the Internal Revenue Code to treat the decedent's IRA as qualified terminable interest property?

FACTS

A died in 1988, survived by *A*'s spouse, *B*. Prior to death, *A* established an IRA described in section 408(a) of the Code. *A* designated the trustee of a testamentary trust established under *A*'s will as the beneficiary of all amounts payable from the IRA by reason of *A*'s death. Under the distribution option irrevocably selected by *A*, the account balance as of *A*'s death must be distributed to the trust in equal annual installments over *B*'s life expectancy. The income earned on the undistributed portion of the account balance received during the calendar year must be distributed to the trust annually, by the close of the calendar year. On *B*'s death, any undistributed balance of the IRA must be distributed to the trust.

Under the terms of the trust, all trust income is payable annually to *B*, and no one has a power to appoint trust principal to any person other than *B*. Accordingly, the trust meets the requirements of section 2056(b)(7)(B)(ii)(I) and (II) of the Code.

In addition, under the terms of the trust and state law, the installments of the IRA balance paid to the trust become trust corpus. All trust expenses normally allocated to corpus, including income tax payable on the IRA distributions, must be charged to corpus. Both the income earned on the undistributed portion of the IRA balance payable to the trust and the income earned by the trust on the distributed portion of the IRA are payable currently to *B*, as income beneficiary of the trust, *A*'s children are the remainder beneficiaries of the trust.

The IRA was includible in *A*'s gross estate under section 2039 of the Code. *A*'s executor elected under section 2056(b)(7) to treat both the IRA and the trust corpus as qualified terminable interest property.

LAW AND ANALYSIS

Section 2056(a) of the Code provides for a deduction from the gross estate of a decedent for the value of property that passes from the decedent to the surviving spouse.

Section 2056(b)(7) of the Code permits a marital deduction for qualified terminable interest property.

Section 2056(b)(7)(B)(i) of the Code defines qualified terminable interest property as property that passes from the decedent, in which the surviving spouse has a qualifying income interest for life, and to which an election applies. Under section 2056(b)(7)(B)(ii) the surviving spouse has a qualifying income interest for life if the surviving spouse is entitled to all the income from the property, payable at least annually, and no person has the power to appoint any part of the property to any person other than the surviving spouse during the spouse's life.

In this case, under the provisions of the irrevocable IRA settlement and the trust instrument, no person has the power to appoint the principal balance of *A*'s IRA (either before or after distribution to the trust) to any individual other than *B*. Therefore, whether *A*'s executor can elect to treat the IRA as qualified terminable interest property is dependent on whether *B* is entitled to all the income for life from the property, payable at least annually.

Under the IRA distribution option elected by *A* and the terms of the testamentary trust, *B* is entitled to all of the income earned on both the distributed and undistributed portions of the IRA and that income is payable annually. Under the terms of the trust, the annual income earned on the distributed portion of the IRA balance must be distributed currently to *B*. The income earned on the undistributed portion is payable annually to the testamentary trust and must be distributed currently to *B* by the trustee. *Because the IRA must distribute all income for the calendar year to the trust by the close of the year and the trust must distribute all income currently to its beneficiary, the trust operates as a mere conduit for payment of the annual income earned in the IRA to B. Thus, the income earned on the undistributed portion of the IRA is considered "payable annually" for purposes of section 2056(b)(7)(B)(ii) of the Code even though it is payable in the first instance to the trust and not to B.*

B, therefore, has a qualifying income interest for life in the IRA for purposes of section 2056(b)(7) of the Code. Furthermore, *B* has a qualifying income interest for life in the IRA for purposes of sections 2519 and 2044 of the Code. Accordingly, on *B*'s death, any remaining undistributed balance held in the IRA, as well as any portion of the IRA balance previously distributed to the trust, will be includible in *B*'s gross estate.

HOLDING

A decedent's executor can elect under section 2056(b)(7) of the Code to treat a decedent's IRA as qualified terminable interest property if (a) the decedent elected an IRA distribution option requiring the principal balance to be distributed in annual installments to a testamentary QTIP trust and the income earned on the undistributed balance of the IRA to be paid annually to the trust and (b) the trust requires that both the income earned on the undistributed portion of the IRA which it receives from the IRA and the income earned by the trust on the distributed portion of the IRA be paid currently to the decedent's spouse for life.

DRAFTING INFORMATION

The principal author of this revenue ruling is Marilyn F. Hale of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Ms. Hale on (202) 535-9540 (not a toll-free call)